



**COMMENTS OF MOBIL OIL CORPORATION**  
**August 4, 1997**  
**on "Supplementary Proposed Rule for**  
**Establishing Oil Value for Royalty Due on Federal Leases,**  
**and on Sale of Federal Royalty Oil"**  
**Department of the Interior**  
**MINERALS MANAGEMENT SERVICE**  
**62 Fed. Reg. 36030, July 3, 1997**

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Mobil Oil Corporation ("Mobil") submits these comments in response to the Supplementary Proposed Rule for Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, published July 3, 1997, in the Federal Register.

**INTRODUCTION**

As Mobil understands the Supplementary Proposed Rule ("SPR"), it makes four changes in the proposed crude oil valuation rule originally published in the Federal Register on January 24, 1997. As a general matter, while these changes take steps to meet at least one of Mobil's concerns, they do nothing to address the core concerns raised with respect to the original proposed rule. In the Comments of Mobil Oil Corporation on Proposed Rules Establishing Oil Value for Royalty Due on Federal Leases, and on Sale of Federal Royalty Oil, dated May 28, 1997 ("Mobil Comments"), Mobil explained in great detail why the proposed index methodology is economically unsound and how it, inter alia, impermissibly discriminates against vertically integrated companies and improperly seeks to ascribe value added to crude oil by downstream marketing efforts to the value of crude at the lease. Mobil further pointed out that the theories underlying the MMS proposals rested on unsupported and erroneous assumptions that frequent or reciprocal transactions between oil companies were somehow anticompetitive or created incentives for parties to such transactions to underprice crude oil artificially. In addition, Mobil addressed substantial procedural, statutory, and practical problems with the proposed rule. None of these shortcomings has been addressed by the SPR.

The SPR is largely an effort at “reformation by tinkering with the details,” Mobil Comments at 6, and at “redrawing the line between ‘true independents’ and others,” *id.*, action that Mobil originally noted was wholly insufficient to cure the conceptual defects of the proposed rule. Therefore, Mobil reaffirms and incorporates by reference its comments (including all exhibits thereto) submitted in response to the original proposed rule on May 28. In addition, Mobil makes the following additional comments on specific changes in the SPR.

**A. Use of Gross Proceeds for Crude Oil Subject to Call Except When Call is “Non-Competitive.”**

The original proposed rule required all oil subject to crude oil calls to be valued for royalty purposes under the index method. The SPR permits valuation of oil subject to call under the gross proceeds method unless the call is “non-competitive.” While this change reduces the number of transactions automatically valued at the index method, its theoretical underpinnings are essentially no different from that of the original rule. It rests on the notion that reciprocal dealings among companies in the oil industry are themselves anticompetitive and part of a collusive market. Indeed, the definition of “non-competitive crude oil call” assumes -- wrongly and without record support -- that any crude oil call that does not have a “Most Favored Nation clause” or some similar provision results in the sale of crude oil at below market value. See Mobil Comments at 27-32, 41-57.

**B. Use of Indexing Method for Arm’s-Length Transactions Subject to an “Overall Balance.”**

The SPR adds an additional category of transactions that would be required to be valued under the index method. Crude oil sold under an arm’s-length contract by a lessee to a third party may not be valued using the gross proceeds method if the parties to the contract sell “roughly equivalent volumes to one another.” 62 Fed. Reg. 36031. This vague concept of “overall balance” is not defined anywhere in the SPR. Moreover, MMS seems to assume that, if two parties

sell “roughly equivalent volumes to one another,” they have agreed to maintain an “overall balance.” The SPR gives no indication how MMS makes the logical connection between arm’s-length sales of “roughly equivalent volumes” of crude oil and an agreement to maintain an “overall balance.” Nor does it suggest how MMS would enforce the provision, what might constitute a “rough equivalence,” or the time period in which this “rough equivalence” would be measured. Until this vague concept is defined, MMS cannot reasonably expect that companies using the gross proceeds method can reliably or meaningfully “certify that [they are] not maintaining an ‘overall balance’ with [their] purchaser.” 62 Fed. Reg. 36031.

Apart from these specific defects, the articulated concern with an “overall balance” again rests on the notion that frequent or reciprocal dealings among oil companies are collusive or anticompetitive. MMS has not and cannot support that premise with credible economic theory or evidence, and therefore this provision of the SPR, like the provisions related to frequent or reciprocal dealings in the original proposed rule, are conceptually flawed.

### **C. Deletion of Two-Year Purchase Provision.**

The deletion of the two-year purchase provision is the one clear substantive improvement the SPR makes over the original proposed rule. The original proposed rule had categorically required any lessee who had purchased crude oil within a two-year period before the date of production to use the index method. Jettisoning that provision effectively makes the exceptions to valuing crude on a gross proceeds method “transaction or contract specific,” as MMS recognizes. Id. at 36032. MMS also makes that point explicit by amendment to section 206.102(a) of the proposed rule.

MMS has requested comments on whether it should amend the original proposed rule “to specify purchase levels below which a lessee would not be required to value their [sic] production using index value.” Id. at 36031. Apparently, MMS is considering some volumetric purchase limitation as a replacement for the original two-year time period contained in the original proposed

rule. As Mobil explained in its May 28 comments, this effort at segregating independent producers from integrated companies is discriminatory and arbitrary. See Mobil Comments at 22-25. For purposes of valuing crude oil for royalty purposes, the status of the lessee is wholly irrelevant, and any provision engrafted onto the rule codifying that discrimination serves no legitimate regulatory purpose.

**D. Valuation of Crude Oil Sold at Arm's-Length After Exchange.**

The SPR adds a new paragraph permitting a lessee who exchanges crude oil produced from a federal lease and then sells the crude oil received on the exchange to use the gross proceeds received from the sale adjusted for location or quality differences paid or received under the arm's-length exchange.

To the extent that this provision applies to exchange agreements with points of delivery downstream of the lease, it again attempts to ascribe value added to crude oil by a lessee's marketing efforts to crude oil at the lease. See Mobil Comments at 17-20. To the extent that it applies to crude oil at the lease, it ascribes alleged "location and quality" differentials to the value of the oil. As Mobil pointed out in response to the original rule, these payments may reflect nothing more than the value of the exchange service provided by one company to another. See id. at 31-32.

**E. Other Comments.**

Finally, MMS requested additional comments on the proposed Form MMS-4415. In response, Mobil adopts and incorporates the additional comments contained in the report of the Barents Group L.L.C., dated August 4, 1997.

MMS also requested "comments on alternatives for valuing production not sold under arm's-length contracts." 62 Fed. Reg. at 36032. Mobil remains of the view that the current regulations adequately and properly use posted prices and comparable transactions at the lease as the appropriate benchmarks for valuing crude oil not disposed of under arm's-length contracts. In the alternative, Mobil

reiterates its view that MMS should take its royalty in kind and so legitimately earn returns for marketing crude oil.

## **CONCLUSION**

Mobil appreciates the opportunity to comment on the SPR and to present its views. While the SPR makes some minor improvements over the original proposed rule, it does not address the fundamental flaws in that proposal. Mobil remains of the view that MMS should withdraw and rethink its proposal.